Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED

AUG 2 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Common Carrier Bureau Seeks Further	)	DA 96-1078
Comment on Specific Questions in	)	
Universal Service Notice of Proposed	)	CC Docket No. 96-45
Rulemaking	)	

FURTHER COMMENTS

National Exchange Carrier Association, Inc.
100 South Jefferson Road
Whippany, New Jersey 07981

August 2, 1996

024

Summary of NECA Responses

Definitions Issues

Questions 1-5 of seek comment on issues relating to the definition of universal service. NECA shows herein that current rates for services generally considered to be within the definition of universal service appear to reflect the economic and service conditions of various areas, and should therefore be deemed "affordable" pending further study of alternative measures, such as nationwide or regional affordability benchmarks.

NECA further shows that the widespread availability of "affordable" telephone service is attributable, in large measure, to the universal service funding policies developed by the Commission and state regulators since enactment of the Communications Act of 1934. Commission programs currently responsible for achieving "affordable" service include the Universal Service Fund (USF), Lifeline Assistance (LA) programs, Dial Equipment Minutes (DEM) weighting rules, common line cost recovery methodologies, and the Telecommunications Relay Services (TRS) fund. These programs must be continued as part of any new universal service programs.

Schools, Libraries, Health Care Providers

Questions 6 - 25 address issues arising under new section 254(h) of the Communications Act. From an administrative perspective, clear guidelines regarding the types of services eligible for discounts are needed to assist in verification of discounts. Funding or offsets to cover the costs of providing discounted services to eligible institutions should be provided to carriers, not to states or other institutions. Similar to the existing Lifeline Assistance mechanisms, carriers that provide discounts to eligible institutions would be able to obtain compensation for those discounts from the program administrator.

NECA also strongly recommends that funds for discounted services provided to schools, libraries and rural health care providers should be kept separate from other universal service funds. This is needed to assure that changes in one fund do not result in unintended impacts for other funds. NECA recommends, however, that the Commission use a common fund collection mechanism for its universal service programs. This would provide efficiencies both for contributors as well as the administrator.

High Cost Fund

Continuation of cost-based funding for small companies serving rural areas is necessary to achieve the goals of the 1996 Act. NECA suggests, however, that certain specific changes to existing programs should be made in order to comply with the 1996 Act. These include replacement of the current presubscribed lines-based allocation method for USF and LA funding with a system based on interstate revenues. To the extent that support amounts are embedded in service rates (e.g., DEM weighting amounts), the Act's "explicitness" requirement can be satisfied by removing such amounts from rates and recovering them via bulk-billed charges. Although it is not clear whether there will be any significant number of entities qualifying for designation as "eligible" in high-cost rural areas, changes to the Commission's rules arguably will also be necessary in order to effectuate Act's requirement for designation of additional eligible carriers.

NECA shows that there is no basis for excluding price cap companies that currently qualify for high cost support from receiving support in the future. Further, as competition develops in urban areas, price cap companies that currently rely on internal cost averaging to equalize rates between urban and suburban areas, will have a correspondingly greater need for universal service support. The 1996 Act requires all subsidies to be made explicit, which should increase the qualification of price cap ECs for high cost support for their high cost service areas.

Proxy Models

NECA's preliminary analysis of proxy models shows that while they bear promise and may work well for larger companies, they should not be used to determine high cost support amounts for small companies. Actual cost results are readily available for small companies. Theoretical cost results produced by proxy models can vary greatly from actual study area costs of small companies. These variances, which are due in part to "mapping" problems between census block groups and actual operating territories of small companies, may not be a significant problem for larger companies but could be devastating for small companies. Accordingly, the Commission should not mandate conversion to proxy systems for small carriers.

Competitive Bidding

As NECA stated in its 1995 NPRM Comments, a system that would determine eligibility for interstate funding of local service based on competitive bids would impose additional costs and create unnecessary complexity, and would require unprecedented Commission involvement in intrastate issues and local service quality monitoring. Allowing support levels to be set on the basis of competitive bids could result in insufficient support payments or a "race for the bottom" as competitive carriers seek to capture funding dollars without regard to maintaining or improving service quality or providing technological advancements. Because of the high capital investment required to serve rural areas, the long-term risks of basing support on competitive bids far outweigh the likely benefits.

Benchmark Cost Model (BCM)

Cost Proxy Model Proposed by Pacific Telesis

NECA's analysis of results produced by the original BCM showed dramatic variances between book costs of incumbent LECS and theoretical costs produced by the model. See NECA 1995 NPRM Comments at 76-82. NECA's preliminary analysis of the original model indicated that substantial additional study is needed before the BCM could be applied to interstate USF distributions.

NECA is currently analyzing the updated BCM ("BCM2) and Pacific Telesis' CPM, and expects to provide comparisons of model results in its August 9th Comments in this proceeding.

SLC/CCLC

NECA shows herein that the carrier common line charge (CCLC) is designed to recover a portion of the joint and common costs associated with providing subscriber line plant. While it is certainly possible to identify the magnitude and proportions of common line costs allocated to the interstate jurisdiction and to particular cost recovery mechanisms, no particular portion of the CCLC or any other common line cost recovery mechanism -- including USF amounts -- can be specifically identified as a "subsidy."

Several alternatives to the CCLC exist for recovery of interstate common line costs allocated to the carrier common line element. For example, the Commission may wish to consider a common recovery mechanism for CCL revenue requirements and interstate high-cost fund revenue requirements. This would require inclusion of interstate CCL amounts within the universal service billing mechanism described in NECA's response to question 26, with amounts to be recovered from interstate carriers based on proportionate shares of interstate revenues. Another approach would be a form of bulk billing similar to that for which NYNEX received a waiver last year.

Low-Income Consumers

Existing Lifeline and Linkup programs should continue; however, the method by which Lifeline Assistance revenue requirements are collected should be changed from the current PSL-based tariff collection method to a revenue-based allocation method, under Commission rules, applicable to all interstate service providers.

Administration of Universal Service Support

Based on its experience in administering the USF/LA program and the TRS program, NECA strongly suggests that the Commission replace the current PSL-based, tariff collection mechanism with a revenue based collection system similar to the TRS mechanism. In addition to being a superior measure of carrier market share, the TRS system eliminates many of the administrative problems associated with the current PSL allocation system.

NECA's experience in administering the TRS fund indicates that per-carrier collection costs are minimal. Accordingly, NECA does not recommend establishment of a "de minimis" for exempting carriers from contributing to the funds. To reduce administrative expenses associated with processing small contributions, the Commission may wish to consider specifying some minimum contribution level, as is done in the TRS context.

CC DOCKET 96-45

UNIVERSAL SERVICE - SUPPLEMENTAL QUESTIONS

NECA Responses

Definitions Issues

1. Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?

Yes. Current rates for services generally considered to be within the definition of universal service (e.g., dial tone, white page directory listings, access to interexchange carrier services, etc.) are based on long-standing public policies and appear to reflect reasonably the service conditions of various areas. Current rates should therefore be deemed "affordable" pending further study of alternative measures.

The widespread availability of "affordable" telephone service throughout the United States, at a 94 percent penetration rate, is one of the major achievements of the twentieth century. This success is attributable, in large measure, to the universal service cost recovery policies developed by the Commission and state regulators since enactment of the Communications Act of 1934.

Commission programs currently responsible for achieving and maintaining "affordable" service include the Universal Service Fund (USF), Lifeline Assistance (LA) programs, Dial Equipment Minutes (DEM) weighting rules, common line cost recovery methodologies,[1] and the Telecommunications Relay Services (TRS) fund. These programs

[1] Commission rules currently require LECs to allocate a flat 25% of their common line costs to interstate, for recovery via end user common line charges and per-minute carrier common line charges. To assure that carrier common line rates of small ECs remain reasonable, the rules require LECs that do not participate in NECA's Carrier Common Line pool to contribute Long Term Support (LTS) amounts to the NECA pool.

have demonstrably been successful in promoting universal service.[2] Current cost-based universal service cost recovery programs help keep local service rates affordable while facilitating deployment of advanced telecommunications infrastructure.[3]

The cost of these achievements has been very reasonable. Existing support mechanisms represent a small portion of overall exchange carrier costs, are small in relation to telecommunications industry revenues,[4] and have continuously declined over time on a per-minute basis.[5] Actions taken by the Commission in this proceeding or related proceedings that reduce recovery of common line costs through carrier common line charges will further reduce the extent to which costs are recovered from long distance carriers and add additional pressure to local rates. Failure to assure continued adequate cost recovery for high cost areas in light of these pressures will result in substantial increases in local rates, especially in rural high-cost areas, reversing the achievements gained in the past 60 years and ending the

---

[2] National Governor's Association (NGA). *Telecommunications, the Next American Revolution* (1994) at 38.

[3] The Commission itself has recognized the value of current federal programs in its Subscribership NPRM. See Amendment of the Commission's Rules and Policies to Increase Subscribership and Usage of the Public Switched Network, CC Docket No. 95-115, Notice of Proposed Rulemaking, 10 FCC Rcd 13003, ¶ 1 (1995) (Subscribership NPRM). See also JSI and Patricia Lum, Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), *Keeping Rural America Connected: Costs and Rates in the Competitive Era*, pp. 2-1 through 2-14, 3-6 and 3-7, 4-1 through 4-15, 5-2 through 5-12, 5-20 through 5-27, 6-1 through 6-17 (1994) (OPASTCO Study). The OPASTCO Study provides a detailed description of the benefits of universal service programs and the negative impacts that would result from their elimination.

[4] See NECA Comments, Appendix A (Oct. 28, 1994), CC Docket No. 80-286.

[5] Id. Data presented in NECA's 1995 Comments showed, however, that over a comparable period of time rates for basic local exchange services have, on average, gone up. NECA Comments at 22 (Oct. 10, 1995), CC Docket No. 80-286.

era of affordable nationwide modern telephone service

2. To what extent should non-rate factors, such as subscribership level, telephone expenditures as a percentage of income, cost of living, or local calling area size be considered in determining the affordability and reasonable comparability of rates?

It is essential that the Commission fully consider the size of local calling areas in determining whether local services provided in particular areas are affordable or "reasonably comparable." This inquiry should take into account local calling scope (e.g., number and types of other subscribers within local calling area) and amount of total bills (local plus toll).

Use of non-rate factors such as subscribership levels, telephone expenditures as a percentage of income and cost of living would be complex and would not be relevant in comparing actual services provided. A broad-brush approach that eliminated all support in some service areas simply because of the presence of a few wealthy subscribers or a vacation resort would plainly be unfair to the vast majority of subscribers in high cost areas who fall below average income levels. For these reasons NECA continues to recommend that programs intended to target high cost areas (such as the current universal service fund) be maintained separately from those intended to assist low income subscribers (such as the current Lifeline Assistance programs)

3. When making the "affordability" determination required by Section 254(i) of the Act, what are the advantages and disadvantages of using a specific national benchmark rate for core services in a proxy model?

A national benchmark for universal service would reduce complexity but would be highly inaccurate because of the diversity of small rural communities (see, e.g., impacts of calling scope discussed in response to question 2 above). What is "affordable" in one area may be out-of-reach for subscribers in other areas. Establishment of a national benchmark rate may also be viewed as a significant expansion of federal regulation in an area traditionally regulated by state commissions. Current methodologies, which measure the relationship of study area loop costs to national average costs, work well and should not be replaced.

4. What are the effects on competition if a carrier is denied universal service support because it is technically infeasible for that carrier to provide one or more of the core services?

Section 214(e) of the 1996 Act requires carriers to provide and advertise universal service throughout a designated service area in order to be deemed "eligible" for universal service support. Universal service can be provided over the carrier's own facilities, or through a combination of owned and resold facilities. 47 U.S.C. § 214(e)(1)(A). Thus, technical feasibility should not be a barrier to qualification as an "eligible" carrier. In any event, the Act permits only "eligible" carriers to receive support for universal service. Accordingly, the public interest would not be harmed by denying support to carriers that fail to qualify under the standards set forth in section 214(e).

5. A number of commenters proposed various services to be included on the list of supported services, including access to directory assistance, emergency assistance, and advanced services. Although the delivery of these services may require a local loop, do loop costs accurately represent the actual cost of providing core services? To the extent that loop costs do not fully represent the costs associated with including a service in the definition of core services, identify and quantify other costs to be considered.

The current universal service fund mechanisms provides high-cost support based on comparisons of individual study area loop costs to the national average. Costs of providing particular services are reflected in investment and expense accounts, as defined by the Commission's Part 32 and Part 36 accounting rules, and recovered, in part, via the universal service fund.

Under the current rules, total company costs are allocated to the loop pursuant to categorization methods developed in the context of CC Docket 80-286. These costs include not only the direct costs of providing physical loop plant facilities but also a portion of other costs, such as general and administrative costs, that are absolutely necessary to the provision of the physical facilities and local services associated with loop plant. As discussed in NECA's 1995 NPRM Comments, these loop costs should continue to be recovered as part of any new universal service mechanism.

The current interstate DEM weighting program permits small exchange carrier study areas to recover additional portions of switching costs from the interstate jurisdiction. As shown in NECA's 1994 NOI Comments and 1995 NPRM Comments, the DEM weighting mechanism (which allocates approximately $350 million per year to interstate) is an effective way of identifying areas that have high per-unit switching costs. Data filed in CC Docket 80-286 show clearly that the DEM weighting rules properly recognize the higher per-minute switching costs of small exchange carriers and that separate recovery mechanisms are necessary for switching- and loop-related costs.[6]

These programs have been extremely successful in promoting and maintaining universal service. Loop and switching costs currently allocated to the interstate jurisdiction

[6] In 1995 NPRM Comments NECA provided analyses of both embedded costs and projected costs of installing new switches that showed that switching costs per unit of demand increases as switch size decreases. In other words, in sparsely populated rural areas, small companies serving only a few customers encounter higher per-unit switching costs. NECA analysis also showed that the DEM weighting rules provide an accurate way of identifying study areas with higher per-unit costs. See NECA 1995 NPRM Comments at 30-47.

through these methods provide a reasonable starting point for determining the interstate cost of providing core universal services

As additional services are provided in high cost areas, current rules may need to be modified to identify costs for recovery The Commission should consider such issues in the context of future reviews of the definition of universal service.

Schools, Libraries, Health Care Providers

6. Should the services or functionalities eligible for discounts be specifically limited and identified, or should the discount apply to all available services?

Section 254(h) of the Act appears to require that the Commission and Joint Board identify particular services and functionalities eligible for discounts. Section 254(h)(1)(A) limits discounts to rural health care providers to services "which are necessary for the provision of health care services in a State, including instructions relating to such services." Section 254(h)(1)(B) defines eligible services for schools and libraries as those "services that are within the definition of universal service" specified under section 254(c)(3) of the Act These provisions appear to require designation of particular services eligible for discounts

From an administrative perspective clear guidelines regarding the types of services eligible for discounts are needed for verification of discounts Such guidelines are also necessary for carriers and the administrator to gauge funding requirements properly

7. Does Section 254(h) contemplate that inside wiring or other internal connections to classrooms may be eligible for universal service support of telecommunications services provided to schools and libraries? If so, what is the estimated cost of the inside wiring and

other internal connections?

Section 254(h) of the Act specifically limits the services for which educational institutions and libraries may receive discounts to those "that are within the definition of universal service under subsection (c)(3)." Subsection 254(c)(3), however, permits the Commission to designate services in addition to those defined as universal service under paragraph 1 of subsection 254(c)(3).

State regulators may take a leading role in determining the need for such funding. In some instances, local service providers have agreed, pursuant to state initiatives, to provide inside wiring and other connections to schools and libraries. Similar to the current lifeline assistance program, clear guidelines should be established to determine the extent to which such initiatives will be eligible for funding from a national fund.

8. To what extent should the provisions of Sections 706 and 708 be considered by the Joint Board and be relied upon to provide advanced services to schools, libraries and health care providers?

Sections 706 and 708 of the Act provide, respectively, for the study and encouragement of advanced telecommunications capabilities for schools and the creation of a National Education Technology Funding Corporation. These provisions appear designed to provide benefits to schools that supplement (but do not replace) the universal service discounts required under section 254(h). By conducting the monitoring proceedings contemplated under section 706 and by coordinating with the new corporation formed pursuant to section 708, it may be possible for the Commission to address the numerous issues identified by commenters in this proceeding regarding technologies and advanced services to be provided to schools and libraries.

9. How can universal service support for schools, libraries, and health care providers be structured to promote competition?

Support for services provided to schools, libraries and health care providers should be structured to assure compliance with the universal service goals and principals set forth in new section 254. Under the Act, all telecommunications carriers serving a particular area are required to offer service at reasonably comparable or discounted rates to eligible institutions. So long as all carriers providing such discounts are able to receive offsets or funding on a non-discriminatory basis, the mechanism will help achieve the Act's objectives without favoring or disfavoring any competitor.

10. Should the resale prohibition in Section 254(h)(3) be construed to prohibit only the resale of services to the public for profit, and should it be construed so as to permit end user cost based fees for services? Would construction in this manner facilitate community networks and/or aggregation of purchasing power?

Section 254(h)(3) states that telecommunications services and network capacity provided to schools, libraries and rural health care providers "may not be sold, resold, or otherwise transferred by such user in consideration for money or any other thing of value. In order to effectuate the intent of this provision the Commission should promulgate rules that limit the availability of section 254(h) discounts to the specific entities described in the legislation (i.e., schools, libraries and health care providers).[7]

---

[7] Under the Commission's 1976 decision in Resale and Shared Use, the term "resale" does not encompass the non-profit sharing of facilities and services among unaffiliated users. See Resale and Shared Use of Common Carrier Services, 60 FCC 2d 261, recon., 62 FCC 2d 588 (1977), aff'd sub nom. American Tel. & Tel. Co. v. FCC, 572 F.2d 17 (2d Cir. 1978). Thus, a prohibition against "resale" in itself, may not be sufficient to prevent misuse of specially-discounted services.

11. <u>If the answer to the first question in number 10 is "yes," should the discounts be available only for the traffic or network usage attributable to the educational entities that qualify for the Section 254 discounts?</u>

See response to question 10, supra.

12. <u>Should discounts be directed to the states in the form of block grants?</u>

No. Section 254(h) requires telecommunications carriers to provide services to eligible institutions at discounted rates. Section 254(h)(1)(A) states that carriers providing discounted services to health care providers "shall be entitled to have an amount equal to the [discount] treated as a service obligation as a part of its obligation to participate in the mechanism to preserve and advance universal service." Similarly, subsections (i) and (ii) of section 254(h)(1)(B) state that discount amounts provided to educational providers and libraries may either be treated as offsets to obligations to contribute to the new universal service mechanism or reimbursed via the fund. This language plainly requires that funding or offsets be provided to carriers, not to states or other institutions.

13. <u>Should discounts for schools, libraries, and health care providers take the form of direct billing credits for telecommunications services provided to eligible institutions?</u>

No. As discussed above in NECA's response to question 12, supra, the Act requires that discount amounts be treated as offsets to carrier obligations to contribute to fund mechanisms and/or be reimbursed to carriers. There does not appear to be a need for the Commission to specify rules governing the way in which such discounts are stated in end user bills (i.e., as discounts, "billing credits" or otherwise).

14. <u>If the discounts are disbursed as block grants to states or as direct billing credits for schools, libraries, and health care providers, what, if any, measures should be implemented to assure that the funds allocated for discounts are used for their intended purposes?</u>

As discussed in NECA's responses to questions 12 and 13, <u>supra</u>, discount amounts must be made available to carriers via offsets or direct reimbursements. To assure that discounted services are provided only to qualified institutions, the Commission should establish clear eligibility criteria, including potential certification requirements. Certification by state or federal government bodies responsible for regulating or funding health care providers, education providers and libraries will help carriers identify eligible institutions (thereby reducing administrative burdens) and help assure that discount cost recovery from the program is used only for the intended purpose.

15. <u>What is the least administratively burdensome requirement that could be used to ensure that requests for supported telecommunications services are bona fide requests within the intent of section 254(h)?</u>

As discussed in NECA's response to question 14, <u>supra</u>, clear procedures and guidelines for determining eligibility must be established in order to assure that requests for discounts are within the intent of section 254(h).

16. <u>What should be the base service prices to which discounts for schools and libraries are applied: (a) total service long-run incremental cost; (b) short-run incremental costs; (c) best commercially-available rate; (d) tariffed rate; (e) rate established through a competitively-bid contract in which schools and libraries participate; (f) lowest of some group of the above; or (g) some other benchmark? How could the best commercially-available rate be ascertained, in light of the fact that many such rates may be established pursuant to confidential contractual arrangements?</u>

Selection of relevant prices in a competitive environment is obviously difficult. Nevertheless, in order to permit verification of discount claims some guidelines will need to be established To the extent that rate comparisons are based on public information (such as tariffed rates or rate schedules filed for informational purposes), administrative burdens will be lessened.

Whatever mechanism is ultimately adopted by the Commission, it should assure that the net costs of telecommunications services for rural schools and libraries are sufficiently low to meet the standard set forth in section 254(h)(1)(b) (i.e., rates that ensure affordable access to and use of universal service by such entities). Telecommunications services provided to rural institutions involve significantly higher transport costs, and involve a greater proportion of toll services. Discounts that are calculated as a flat percentage off a distance sensitive base rate would not reflect these differences. Consideration must be given to the actual net costs encountered by these institutions in obtaining similar levels of service

17. How should discounts be applied, if at all, for schools and libraries and rural health care providers that are currently receiving special rates?

There may be instances where service is currently provided to schools, libraries or rural health care providers at rates lower than those found to be required by the Commission pursuant to section 254(h). In no event should the Commission promulgate rules that require the discontinuance of such arrangements. Clear guidance should be provided to carriers and the administrator, however, for reimbursement in such cases. The Commission could, for example, authorize reimbursement for the full amount of such discounts, or it could specify that reimbursement from a universal service fund will be available up to the amount that would have been paid if service was provided at the rate found to be in the public interest under section 254(h).

18. What states have established discount programs for telecommunications services provided to schools, libraries, and health care providers? Describe the programs, including the measurable outcomes and the associated costs.

NECA does not currently maintain data or information on discount programs for telecommunications services provided to schools, libraries or rural health care providers.

19. Should an additional discount be given to schools and libraries located in rural, insular, high-cost and economically disadvantaged areas? What percentage of telecommunications services (e.g., Internet services) used by schools and libraries in such areas are or require toll calls?

Additional discounts may be necessary in order to assure that the net costs of telecommunications services are low enough to ensure affordable access to and use of universal service by schools and libraries located in rural, high-cost and insular areas. Local access to Internet services is becoming increasingly available, but, as discussed in NECA's response to question 16, supra, calls to information service providers from rural areas often involve long transport mileage and/or toll charges. Discount programs may need to reflect these factors. Also, subscribers located in outlying areas have encountered difficulties in connecting to advanced services, partly because of problems with physical facilities (e.g., the need to use loading coils in transmission lines, which slow down modem transmission speeds). Universal service programs that are sufficient to promote deployment of modern infrastructure will help alleviate these concerns.

20. Should the Commission use some existing model to determine the degree to which a school is disadvantaged (e.g., Title I or the national school lunch program)? Which one? What, if any, modifications should the Commission make to that model?

NECA does not currently maintain data on the validity of such models.

21. Should the Commission use a sliding scale approach (i.e., along a continuum of need) or a step approach (e.g., the Lifeline assistance program or the national school lunch program) to allocate any additional consideration given to schools and libraries located in rural, insular, high-cost, and economically disadvantaged areas?

Should the Commission determine that additional funding is required for schools and libraries located in rural, insular, high-cost, and economically disadvantaged areas, it may find that it is more equitable to structure the support on a sliding scale. Use of a step approach may cause significant and unnecessary dislocations as a school or library is moved from one step to the next as a result of some external factor unrelated to the economic need of the institution. As suggested in NECA's response to question 16, however, the primary consideration in such cases should be the extent to which schools encounter extraordinary charges for services (e.g., transport) as a consequence of location in a rural, high-cost or insular area

22. Should separate funding mechanisms be established for schools and libraries and for rural health care providers?

Yes. Specifically-targeted funds should be kept separate from one another. For example, while funds from the federal Universal Service Fund and Lifeline Assistance programs are both made available to exchange carriers, these programs are dissimilar in nature, as one is targeted to companies serving high cost areas and the other to low-income subscribers. Likewise, funds for schools and libraries are targeted to advance education, and should not be commingled with amounts for services provided to rural health care providers, nor should either fund be mixed with funds targeted to high-cost universal service areas.

As discussed in its response to question 72, infra, NECA does recommend that the Commission use a common fund collection mechanism for its universal service programs.[8] This would provide efficiencies both for contributors as well as the administrator. Resulting funds should be maintained separately, however, in order to avoid unexpected changes in one type of fund from creating unintended impacts in other funds.

23. Are the cost estimates contained in the McKinsey Report and NII KickStart Initiative an accurate funding estimate for the discount provisions for schools and libraries, assuming that tariffed rates are used as the base prices?

NECA does not currently maintain data or information on these programs.

24. Are there other cost estimates available that can serve as the basis for establishing a funding estimate for the discount provisions applicable to the schools and libraries and to rural health care providers?

NECA does not currently maintain data or information on fund requirements for these entities.

25. Are there any specific cost estimates that address the discount funding estimates for eligible private schools?

NECA does not currently maintain data or information on fund requirements for these entities.

High Cost Fund

General Questions

---

[8] As discussed in response to question 72, infra, a modified version of the current FCC Form 431 could be used to determine all contribution amounts

26. <u>If the existing high-cost support mechanism remains in place (on either a permanent or temporary basis), what modifications, if any, are required to comply with the Telecommunications Act of 1996?</u>

New section 254(d) of the Communications Act, added by the Telecommunications Act of 1996, requires that "every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable and sufficient mechanisms established by the Commission to preserve and advance universal service." 47 U.S.C. § 254(d)

NECA continues to support replacement of the current presubscribed lines-based allocation method for USF and LA amounts with a system based on interstate revenues. Currently, USF and LA charges are assessed upon all interexchange carriers that have at least .05% of the total common lines presubscribed to interexchange carriers in all study areas. <u>See</u> 47 C.F.R. § 69.5 As noted above, however, the 1996 Act requires that contributions to the new universal service support mechanism are to be made on an equitable and non-discriminatory basis by all interstate telecommunications carriers. Replacement of the current presubscribed lines allocation method with a revenue-based method, similar to that used for TRS fund contributions, should satisfy this requirement. New section 254(e) of the Act requires that universal service support amounts be "explicit and sufficient." 47 U.S.C. 254(e). Current Universal Service Fund, Lifeline Assistance and TRS fund mechanisms satisfy the Act's "explicitness" requirement, since they are each specifically identified, collected via explicit charges or assessments, and distributed to eligible carriers according to well-defined formulas. USF distributions to individual carriers are stated in NECA's annual USF data submissions, filed in late September of each year.

To the extent that other support amounts are embedded in service rates (e.g., DEM weighting amounts), the Act's "explicitness" requirement can be satisfied by removing such amounts from rates and recovering them via bulk-billed charges.

As discussed in NECA's 1994 NOI Comments and 1995 NPRM Comments in CC Docket 80-286, allocation of support amounts to large company high cost areas using proxy methodologies could expand fund requirements significantly. Reductions in the recovery of costs via carrier common line charges will create substantial upward pressure on local rates. To satisfy the Act's "sufficiency" requirement in these circumstances it is imperative that the Commission discontinue the current interim cap on the Universal Service Fund and refrain from imposing any form of cap on new universal service cost recovery. It is also critical that the Commission takes steps to assure that changes in other types of support funding (e.g. funding for discounted services to schools, libraries and rural health care providers) do not adversely affect cost recovery levels for small companies relying on continuation of current high cost mechanisms.

Nothing in the 1996 Act mandates the replacement of current cost-based universal service mechanisms with other mechanisms such as proxies. As discussed in NECA's April 12 Comments in this proceeding, it is critically important that universal service support levels under any new system be based on the most accurate and complete cost of service information available. For some larger companies, this might be obtained using proxy models in lieu of cost study data. For smaller companies, however, cost study data, which are readily available, are the only proven, reliable basis for determining sufficient levels of universal service support. Continuation of cost-based funding for small companies serving rural areas is necessary to achieve the goals of the 1996 Act.

Section 214(e) of the Act contemplates the designation of non-incumbent exchange carriers as "eligible" carriers for universal service support. Inasmuch as current high cost recovery is available only to incumbent exchange carriers, changes to the Commission's rules will arguably be necessary in order to effectuate this requirement.

As NECA pointed out in its April 1996 Comments in this proceeding, it is not clear whether there will be any significant number of entities qualifying for designation as "eligible" in high-cost rural areas. Passage of the 1996 Act did not alter the underlying economics of serving rural America. Competition simply may not be viable in high cost rural areas. Complicated support mechanisms designed to make support payments available to new entrants in these areas may only distort competition, without producing any real benefits for consumers.

To ameliorate these effects, Commission rules implementing section 214(e) should make clear that universal service support amounts would be available only to designated eligible carriers that actually serve entire designated service areas, not simply portions thereof or selected high-volume customers. See 47 U.S.C. § 214(e)(1)(A). Further, support amounts should reflect the extent to which carriers actually incur costs. It is possible that some carriers may provide universal service primarily by reselling discounted services or facilities obtained from an underlying carrier. Universal service support in these instances must go to the underlying carrier, since that entity is the one incurring the costs of building and maintaining the facility. The underlying carrier, in turn, would reflect the support in the price of the facility offered to the reseller.

In order to make support payments available on a non-discriminatory basis to non-incumbent eligible carriers the Commission should require such carriers to perform the same accounting and categorization studies currently performed by incumbent LECs. This approach was suggested by a number of commenters, including NECA, in the comment round of this proceeding.[9] As NECA pointed out in its comments, the Commission's cost accounting rules have been used for many years by incumbent LECs, many of which are quite small. Application of these rules to new eligible carriers would not impose any greater burdens than those imposed on small LECs.

If the Commission were to adopt such an approach, however, rule revisions would be needed to assure that per-line universal service payments to new eligible LECs do not exceed amounts payable to the incumbent LEC. Such limits would be necessary in order to avoid competitive distortions and maintain reasonable fund levels.[10]

27. <u>If the high-cost support system is kept in place for rural areas, how should it be modified to target the fund better and consistently with the Telecommunications Act of 1996?</u>

In addition to the modifications discussed in NECA's response to question 26, NECA believes that the current high-cost system could be improved by adopting "sliding scale" methodologies in place of the current "stepped" formulas used in calculating DEM

---

[9] See, e.g., CC Docket No. 96-45, Comments of the Rural Telephone Coalition at 11-13, United States Telephone Association at 17 (filed April 12, 1996).

[10] In its April 12 Comments NECA suggested that this could be accomplished by comparing actual cost per line data of new eligible carriers to incumbent LEC costs. Since significant differences in costs can exist between lines serving towns and those serving outlying areas, it would be necessary to disaggregate costs below the study area level for incumbent LECs.

weighting amounts. See NECA 1995 NPRM Comments at 44. In addition, NECA has suggested that the existing USF mechanism can be improved by adopting revisions to the Part 36 data reporting rules to allow companies involved in mergers and acquisitions to adjust annual USF data to avoid mismatches between end-of-year investment data and partial-year expense data. Id. at 60-62 and Appendix F. Finally, NECA has suggested that, if the Commission is concerned about excessive levels of general and administrative expenses included in universal service fund amounts, it may wish to consider using statistical measures, such as the two standard deviation test proposed by NECA in its 1995 NPRM Comments (at 60) to limit the amount of such expenses allocated to USF.

28. What are the potential advantages and disadvantages of basing the payments to competitive carriers on the book costs of the incumbent local exchange carrier operating in the same service area?

Incumbent carrier book costs would not provide a good basis for payments to competitive carriers. Costs recorded in incumbent carriers' books reflect pre-competitive regulatory policies, when these carriers were required to deploy sufficient plant to be "ready to serve" substantially all areas within a given territory, and to delay capital recovery of this investment pursuant to long depreciation schedules. As a result, incumbent LECs' book costs in many cases would have no rational relationship to competitive entrants' costs, particularly where a non-incumbent eligible carrier is providing universal service via resale of incumbent LEC services at a discounted rate. Distributions to competitive LECS based on incumbent LEC book costs, in these cases, would be too high, in effect "paying" for competition.

29. Should price cap companies be eligible for high-cost support, and if not, how would the exclusion of price cap carriers be consistent with the provisions of section 214(e) of the Communications Act? In the alternative, should high-cost support be structured differently for price cap carriers than for other carriers?

Several price cap companies provide service in study areas that are considered high cost under current rules. In addition, virtually all price cap companies are required to provide service in areas that would qualify as high cost areas under current rules, but do not so qualify because of study area averaging effects. For example, US WEST, a price cap company, provides service to extensive high cost areas in rural Western states but is generally not eligible for high cost support because its costs of serving high-cost rural areas are averaged in with costs of serving low-cost large cities in the same study areas.

There is no basis for excluding price cap companies that currently qualify for high cost support from receiving support in the future. Further, as competition develops in urban areas, price cap companies that currently rely on internal cost averaging to equalize rates between urban and suburban areas, will have a correspondingly greater need for universal service support. The 1996 Act requires all subsidies to be made explicit, which should increase the qualification of price cap ECs for high cost support for their high cost service areas.

Several parties in this proceeding and the Commission's Docket 80-286 proceeding have proposed the use of proxy formulas to determine costs of serving individual "census block groups" rather than large study areas. These models would allow large companies, such as the price cap ECs, to determine costs below the study area level and would enable the Commission to target high cost support to these companies more accurately.

If the Commission permits larger companies (however defined) to receive additional high-cost assistance, care must be taken to assure that smaller companies are not adversely affected. If universal service cost recovery were "capped," for example, the addition of thousands of large company census block groups to the cost recovery mechanism could cause virtually all available funds to be transferred to larger companies. This result must be avoided by eliminating the current interim "cap" and/or by establishing separate funds or priorities on available funds for small companies.

30. <u>If price cap companies are not eligible for support or receive high-cost support on a different basis than other carriers, what should be the definition of a "price cap" company? Would companies participating in a state, but not a federal, price cap plan be deemed price cap companies? Should there be a distinction between carriers operating under price caps and carriers that have agreed, for a specified period of time, to limit increases in some or all rates as part of a "social contract" regulatory approach?</u>

If the Commission determines that different high-cost rules should apply to companies based on their status as "price cap" or "rate of return" companies, NECA recommends that such distinctions be made by reference to the federal tariff status alone. Attempts to distinguish among various forms of state tariff or pricing regulation may add unnecessary complexity to the process, and increase administrative expenses.

31. <u>If a bifurcated plan that would allow the use of book costs (instead of proxy costs) were used for rural companies, how should rural companies be defined?</u>

If the Commission determines that different high-cost rules should apply to companies based on their status as "rural" or "non-rural," NECA recommends that the Commission adopt the definition of "rural telephone company" set forth in new section